



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT  
FOR NOVEMBER 2003**

**DATE:** January 6, 2004

---

Approved

Date

---

## INFORMATION ONLY

The Monthly Financial Report (MFR) for November was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

## OVERVIEW

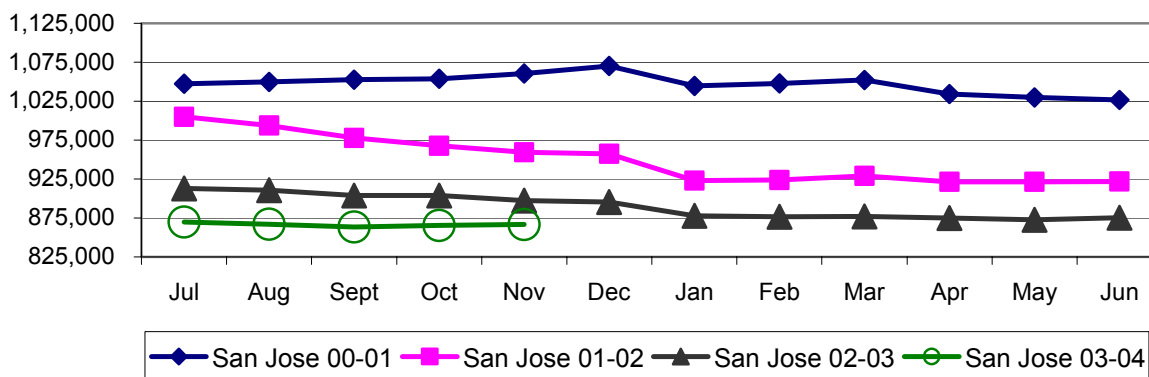
A review of the financial activity for the City in November and through the first quarter of the fiscal year continues to confirm that the City remains mired in a severe and persistent slowdown in the local economy which is now entering a third straight year. This situation continues to negatively impact collections of most of the City's major revenue sources. Although the regions's economic situation appears to have stabilized somewhat, the signs of economic growth being seen both nationally and elsewhere in the State are not yet being evidenced locally.

Since our last report, we have received disappointing information of particular note concerning our largest economically sensitive revenue category – General Sales Tax. Although not reflected in the November numbers contained in this report, the City received First Quarter General Sales Tax receipt information in late December. The news was once again not good. Receipts were down a tenth consecutive quarter, falling 0.9% from the prior year level. Although we have seen the level of decline in General Sales Tax revenue lessen in recent quarters, the decline was still particularly disturbing because that drop was in comparison with a poor prior year quarter that had itself been down by 9.6% from the same quarter in fiscal year 2001-2002. Because we were conservative in our budget estimate, however, we would achieve the budgeted estimate even if we averaged a 1% decline in General Sales Tax revenues for the remaining three quarters of the year.

It is our continued belief that the most crucial indicator of economic health continues to be the employment situation in the County, and regrettably, an anemic employment situation and continued job losses still characterize our economy (see below).

**OVERVIEW (CONT'D.)**

San José Metropolitan Statistical Area  
(Santa Clara County)  
**Employment: Total Jobs Comparison**

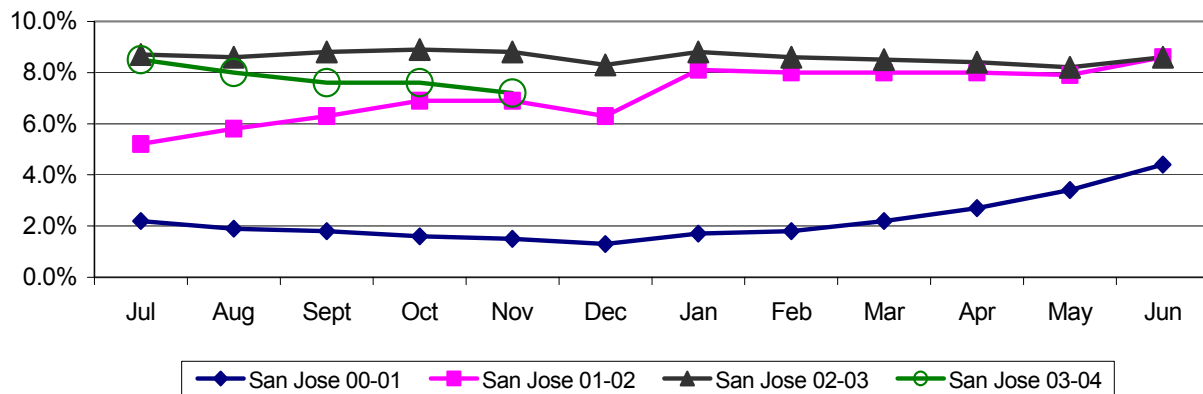


The November employment numbers indicate that while the rate of the drop-off in the number of jobs may have lessened, and the unemployment rate leveled off, significant job losses continue to plague the Valley, particularly in the key technical and manufacturing job categories. The trend of offshore migration of many of the types of jobs previously prevalent in the area continues, and in fact seems to be accelerating. There are absolutely no signs of the type of increases in employment that will be needed to pull us out of the current economic situation.

It is true that November's unemployment rate of 7.2% was down slightly from October's adjusted rate of 7.6% (see below). However, the one seemingly bright sign in the report (the number of jobs in the County ticked up slightly for the first time in a while, increasing by 1,100, from 865,400 to 866,500) appears to be a result of normal seasonal hiring patterns rather than any indication of true growth. The overall job situation continues to be bleak. San Jose experienced an overall 3.4% decrease in jobs for the year, and the County unemployment rate through November remained well above both the State and national rates, which were 6.4% and 5.6%, respectively. Significantly, as noted above, according to the California Employment Development Department, the key manufacturing sector recorded a yet another net loss (500 jobs) during the month. The biggest contributor of that drop was again our most important economic sectors: electronics equipment, industrial machinery, and instruments and related products industries. The MBIA MuniServices October economic report summarized our situation quite well by pointing out that "the Bay Area in the past year has actually lost more jobs than the entire state, meaning that the rest of the state has added jobs even as this region continues to lose them."

**OVERVIEW (CONT'D.)**

San José Metropolitan Statistical Area  
(Santa Clara County)  
**Unemployment Rate Comparison**



In summary, the first five months of the year were characterized, as have the last two years, by continuing weakness in all of our key economically sensitive revenues. Fortunately, however, the 2003-2004 General Fund Adopted Budget revenue estimates were based on an assumption of continued economic woes. So, even taking into account the specific one-time unanticipated problems (discussed below) in two key revenue sources, Motor Vehicle License Fees and Electricity Utility Taxes, which will result in collections falling short of budgeted expectations in those two categories by approximately \$2.4 million, overall collections in the General Fund are still performing just slightly under (less than \$1.0 million) budgeted levels.

It is much too early, however, to predict whether we will remain in this position. Our year-end status will depend most heavily on the final status of two key revenues. First, we need to achieve the budgeted level of Sales Tax collections for the remainder of the year. No additional data will be available regarding Sales Tax performance until March, when the next quarterly receipts will be available. The other major unresolved issue is of course, the potential loss of State Vehicle License Fees (VLF) resulting from the actions of the new Governor repealing the recent increase in those fees. We have a huge exposure should the backfill now under debate not be provided (\$28 million). The loss of funds of that magnitude would, of course, throw us into an immediate financial crisis, and contingency planning has been underway for some time to develop options for the Council to consider should that loss prove unavoidable. The time it takes to resolve the uncertainty is also very critical. Obviously, the longer the State takes to resolve the issue of funding the VLF backfill this year, the less time the City would have to resolve the current fiscal year shortfall. The Council will be continuously updated on the status of our monitoring through these MFR reports as the year progresses, and an overall description of our fiscal situation provided at budgetary workshops scheduled for January 15, and in early February, as part of the Mid-Year Budget Review.

## **OVERVIEW (CONT'D.)**

It should be noted that in response to the continued weak economic performance, and in light of the uncertainty regarding the State situation, the Administration has continued and in fact strengthened the aggressive cost control strategies that have been in place for well over a year. A city-wide hiring freeze continues to be in effect – all job offers including those for public safety positions were suspended by the City Manager in mid-December, pending resolution of the VLF situation. Also continuing are the freezes on various non-essential expenditure categories (e.g., overtime, travel, technology purchases, marketing, etc.). In addition, earlier this year, General Fund departments were assigned Cost/Position Management Plans for the 2003-2004 fiscal year, which cumulatively total approximately \$9 million. These plans have been submitted and are under review by the Budget Office. All departments have been notified that additional reduction options for this fiscal year, should the VLF revenue loss prove to be a reality, may be necessary.

## **GENERAL FUND**

### **Revenue Collections**

General Fund revenues through November 2003 totaled \$231.6 million. This was an increase of \$9.5 million (4.3%) from the November 2002 level of \$222.1 million. This performance was primarily driven by growth in the Transfers and Reimbursements category (\$12.5 million or 31.5%) along with increases in the following revenue categories: Utility Tax, Licenses and Permits, Revenue from Local Agencies, Departmental Charges, and Other Revenue. Growth in those categories was partially offset by decreases in the following revenue categories: Property Tax, Sales Tax, Transient Occupancy Tax, Franchise Fees, Use of Money and Property, and Revenue from the State of California.

The following discussion highlights General Fund activities through November:

### **KEY GENERAL FUND REVENUES** (\$000's)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Property Tax</b>	<b>\$ 92,438</b>	<b>\$ 21,672</b>

Year-to-date Property Tax revenues reflect collections in Secured Property Tax, Unsecured Property Tax and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Secured Property Tax revenues through November represent advances only and are not necessarily reflective of final collections. Initial information from the County does indicate, however, that this category will end the year at, or above, budgeted expectations. Staff is working with the County to confirm this preliminary information.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Property Tax (Cont'd.)</b>	<b>\$ 92,438</b>	<b>\$ 21,672</b>

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through November, Unsecured Property Tax receipts of \$10.4 million are 11.4% below last year's level of \$11.7 million. A falloff had been anticipated, and this performance is within budgeted levels. It should be noted however, that performance in this category over the past decade has been extremely volatile and subject to sharp changes as the economy shifts. Staff will continue to monitor this revenue source closely and work with the County to obtain additional information to determine whether adjustments might be needed before year-end.

With the adjustments for accrual reversals and timing differences, SB 813 payments through November of \$615,000 are down 22.7.0% from last year's comparable collections of \$796,000. Collections in this category, representing payments for taxes owed on recent housing re-sales, are typically a leading indicator of a drop in sales activities. The Adopted Budget anticipated a significant decline in this category, presuming a drop of 10.0% from the prior year level. We will need to watch closely to ascertain whether an additional adjustment may be necessary later in the year.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Sales Tax</b>	<b>\$ 128,818</b>	<b>\$ 31,925</b>

General Sales Tax receipts for November represent only State formula advance payments. Collections of \$31.9 million tracked 10.3% lower than the \$35.6 million collection in the prior year. Because these are advance payments, however, the decline through November is not necessarily indicative of an actual drop in receipts.

However, in December, the City received the most recent quarterly Sales Tax report from the State. As discussed in the overview section of this report, the City's collections levels continue to be weak, with a 0.9% decline from the same quarter last year, which represents our tenth consecutive quarterly decline in Sales Tax receipts. Information regarding economic sector performance and the collection performance for surrounding cities and the State as a whole is currently being combined by our Sales Tax consultants and will be made available as part of the Mid-Year Budget Review.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Transient Occupancy Tax</b>	<b>\$ 6,719</b>	<b>\$ 1,619</b>

Transient Occupancy Tax (TOT) collections through November of \$1.6 million were below last year's level of \$1.8 million for the same period and 24.5% lower than the year-to-date estimate of \$2.0 million. This decrease indicates continued softness in this area with minimal growth expected the rest of the fiscal year. This is a disappointment given our budgeted expectation for some improvement in this sector beginning this fiscal year.

The November 2003 occupancy rate in the largest hotels was a dismal 42.2%, significantly down from both the November 2002 rate of 52.2%, and the October 2003 rate of 50.4%. An additional sign of continued weakness in the local hospitality market is the fact that while the number of rentable rooms remains relatively stable, the average room rate continues to drop, from \$115.46 in November 2002 to \$107.22 in November 2003. We will continue to monitor this situation, but believe that a further downward adjustment to the estimate for this revenue source will almost certainly be required as part of the mid-year budget.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Franchise Fees</b>	<b>\$ 32,406</b>	<b>\$ 12,150</b>

Collections of \$12.2 million from Franchise Fees were below the November 2002 collection level of \$12.8 million. This negative variance reflects net lower collections in Electric and Gas Franchise Fees and lower than anticipated collections from City Generated Tow Franchise Fees. The receipts related to Electric and Gas Franchises Fees are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in calendar year 2002, and are not necessarily indicative of actual expected receipts. In addition, as reported to the City Council in June 2003, net receipts also reflect the repayment of \$183,236 to PG&E for overpayments made to the City in 2002-2003. In April 2004, PG&E will calculate the actual Franchise Fees due in 2003-2004 based on calendar year 2003 activity. City Generated Tow Franchise Fees are anticipated to meet budgeted expectations.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Franchise Fees (Cont'd.)</b>	<b>\$ 32,406</b>	<b>\$ 12,150</b>

The California Public Utilities Commission (CPUC) recently approved a settlement agreement between Pacific Gas & Electric Company, its parent PG&E Corporation, and the CPUC, which paves the way for the utility to emerge from bankruptcy. A federal bankruptcy judge later confirmed the agreement. The settlement agreement provides for significant rate reductions to the utility's customers. Although there are not enough details currently available for an exact analysis of the impact of the rate reductions, an initial review indicates the possibility of significant on-going reductions of both electrical Franchise Fees and Utility Taxes in the combined range of \$3.0 million to \$3.5 million.

Commercial Solid Waste Franchise Fees of \$2.7 million are approximately 5.1% above the prior year level of \$2.5 million. Preliminary discussions indicate, however, that this performance is due to timing differences in receipts and variances in accruals compared to the previous year. In fact, preliminary estimates indicate that this revenue category may actually fall below budgeted expectations due to the continued weak economic climate as well as to commercial diversion programs. The Budget Office will continue to work with the Environmental Services Department to analyze current year performance and assess whether a downward adjustment should be recommended.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Utility Tax</b>	<b>\$ 66,979</b>	<b>\$ 24,169</b>

Utility Tax collections of \$24.2 million are 2.2% above last year's level of \$23.6 million. This performance reflects slightly higher collections in the Gas, Water, and Telephone Utility Tax, offset by lower collections in Electric Utility Tax. As discussed in prior MFRs, the projection for a shortfall in the Electricity Utility Tax is the result of a September announcement by the California Public Utilities Commission that it has ordered an unanticipated one-time rebate to PG&E customers. The negative impact of that rebate on the City is projected at approximately \$1.1 million. Although increases in natural gas prices and slight increases in overall usage have Gas, Water, and Telephone revenues tracking slightly higher than last year, it is not anticipated that this small increase can offset the reduction in Electricity taxes. It is likely that a downward adjustment to this revenue category will therefore be required at mid-year.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Utility Tax (Cont'd.)</b>	<b>\$ 66,979</b>	<b>\$ 24,169</b>

As noted above, the CPUC recently approved a settlement agreement between Pacific Gas & Electric Company, its parent PG&E Corporation, and the CPUC that provides for significant rate reductions to the utility's customers. Although there are not enough details currently available for an exact analysis of the impact of the rate reductions, an initial review indicates the possibility of significant on-going reductions of both electrical Franchise Fees and Utility Taxes in the combined range of \$3.0 million to \$3.5 million.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Licenses and Permits</b>	<b>\$ 66,748</b>	<b>\$ 33,377</b>

On an overall basis Licenses and Permits revenue of \$33.4 million through November was 27.1% above the prior year level of \$26.3 million.

Cardroom Business Tax collections of \$2.7 million were well above the prior year level of \$2.1 million. This performance, however, is not comparable to the prior year due to the Bay 101 bankruptcy filed in July 2002 where revenue was not received during that period. This revenue category is expected to meet budgeted expectations of \$7.5 million.

Disposal Facility Tax revenue of \$4.9 million was 12.2% lower than the prior year level of \$5.5 million. This reflects the fact that BFI and Waste Management have taken issue with the removal of the Alternate Daily Cover exemption approved by the City Council last year. Pending a resolution of this \$1.8 million dispute, by agreement with the City Attorney's Office, BFI and Waste Management are paying amounts related to alternative daily cover into an escrow account, rather than the General Fund. The Attorney's Office is attempting to negotiate an outcome that will hold the General Fund harmless for any loss of revenue, but we will need to work with the Environmental Services Department and the City Attorney's Office to monitor the status of this issue and its impact on City revenue collections.

Fire Permit revenues of \$2.5 million are flat when compared to the prior year's revenues. This performance is below the amount anticipated in the budget, and current projections indicate that these revenues could end the year as much as \$1 million below the budgeted amount. At the present time this reduction in revenues can be only partially offset by salary savings in fee program costs. The status of the Fire fee program will continue to be closely monitored and, if necessary, adjustments to the budgeted estimate will be recommended as part of the Mid-Year Budget Review.



**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Licenses and Permits (Cont'd.)</b>	<b>\$ 66,748</b>	<b>\$ 33,377</b>

Building Permit revenues of \$9.6 million, in contrast, are tracking well above both the budgeted level (23.9%) and last year's collection level (51.4%). Revenues through November collected in all categories performed at or above anticipated levels. A change in the building code that was to be effective on November 1 apparently resulted in a significant increase in October activity. It is expected, however, that revenue collections will smooth out over the remainder of the year.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Use of Money and Property</b>	<b>\$ 9,492</b>	<b>\$ 3,081</b>

The Use of Money and Property revenue of \$3.1 million in November was significantly below the prior year level of \$4.5 million, reflecting lower cash balances and interest earnings. The General Fund cash balance for November was down to \$143.5 million, as compared to the prior year's balance of \$167.6 million, a decline of 14.3% or \$24.0 million. Although a significant decline in cash balances had been anticipated, this level was below that assumed in the Adopted Budget, and causes concern regarding the ability to achieve budgeted revenue levels. In addition the potential loss of all VLF backfill revenue, as noted below under Revenue from the State of California, would result in a lower cash flow and an additional decline in interest income. Continued close monitoring will be required in this category.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Revenue from the State of California</b>	<b>\$ 47,945</b>	<b>\$ 8,395</b>

Revenue from the State of California through November totaled only \$8.4 million, which represented a significant decline from the prior year collection level of \$17.5 million. The drop of course reflects the impact of the reduction in Motor Vehicle In-Lieu Fee (VLF) payments included as part of the State budget balancing actions. (As a reminder, what was represented as a "one-time" impact resulted from the ramp-up time necessary to fully implement the increase in the VLF fees offset by actions approved by Council in the State budget balancing package approved in September).

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Revenue from the State of California (Cont'd.)</b>	<b>\$ 47,945</b>	<b>\$ 8,395</b>

Actions were approved by the City Council revised the budget estimate accordingly, resulting in a \$10.5 million decrease to the VLF category. As discussed in the October MFR, subsequent to the September re-balancing actions, it was determined that a key assumption, based on State assurances, used to estimate prior year revenues in this category has proven to be incorrect. Based on statements from the State Controller, the Finance Department presumed that a VLF payment in the amount of \$1.3 million due to the City in June, which was delayed, would eventually be paid. An accrual in that amount was, as a result, included in the final 2002-2003 closing statements. We since learned that, those assurances notwithstanding, this payment will not be forthcoming. The result is an additional shortfall of \$1.3 million in current year collection totals over and above any shortfalls resulting from the actions raising and then lowering VLF fees.

Of intense interest to the City of course, are the implications of the action of the new Governor rescinding the increase in VLF (retroactive to when it was raised) and the potential loss of all VLF backfill to the City should the VLF backfill not be restored. The result of this action would be the loss of an additional \$27.7 million on top of the \$10.5 million and \$1.3 million decreases noted above. It is still unclear what the final outcome of this issue will be. The special session of the legislature called by the Governor to address this and other issues ended with no action to backfill VLF revenue loss. Shortly thereafter the Governor announced, with the support of the State Controller, that he would declare a state emergency and unilaterally restore the VLF backfill, at least for the remainder of the year. The legality of this action has been challenged by several legislators and the Legislative Analyst. At this writing the outcome of this dispute is unknown. Should the final outcome prove to be the loss of backfill for the remainder of the year, the City will be forced to very quickly implement actions necessary to bring the General Fund budget back into balance. Options for such actions have been under review for several weeks and will be presented to the Council quickly, should this prove necessary.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Departmental Charges</b>		
<b>-Public Works</b>	<b>\$ 6,405</b>	<b>\$ 3,520</b>

Public Works revenues through November of \$3.5 million were 37.9% above the prior year level of \$2.6 million. While the best performing categories are residential engineering and non-residential engineering, nearly every category is performing better than it was through the same period last year. It remains unclear if this improved performance can be sustained over the rest of the year. The increased revenue is partially offset by lower than anticipated collections in the floodplain management and water quality runoff categories. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>-Transportation</b>	<b>\$ 792</b>	<b>\$ 747</b>

Transportation Revenues of \$0.7 million tracked 186.7% above the prior year level of \$0.3 million. The strong performance has been driven by unanticipated one-time receipts for Signal Review in the North Coyote Valley, by higher than anticipated collections in the Miscellaneous Traffic Charges category, and by Residential Permit Parking collections which have tracked strongly at the beginning of this year due to permit renewals in the summer. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>-Planning, Building, &amp; Code Enforcement</b>	<b>\$ 5,129</b>	<b>\$ 1,930</b>

Planning Permit revenue of \$1.9 million is well above last year's collection level at this point in time, and running at anticipated levels. Revenue activity for 2003-2004 assumed the same level of activity as 2002-2003, with increases of 15.0% as approved by the Council.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Other Revenue</b>	<b>\$ 15,442</b>	<b>\$ 9,449</b>

Other Revenue collections of \$9.4 million were \$1.3 million above the prior year level of \$8.1 million. This increase from the prior year primarily reflects a planned increase in reimbursement from the Arena Authority. Overall collections appear to be within budgeted expectations.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Transfers and Reimbursements</b>	<b>\$ 86,381</b>	<b>\$ 52,007</b>

Transfers and Reimbursement collections of \$52.0 million were significantly above the prior year level of \$39.5 million. This performance through November was, however, primarily driven by various budgeted transfers to the General Fund, primarily transfers from the Healthy Neighborhood Venture Fund (\$10.0 million) and the Vehicle Maintenance and Operations Fund (\$2.9 million). Overall collections appear to be within budgeted expectations.

**EXPENDITURES**

Through November, General Fund expenditures of \$266.0 million were 6.5% below (down \$18.5 million) the prior year level of \$284.5 million. Encumbrances of \$39.8 million were 38.6% below (down \$25.0 million) the prior year level of \$64.8 million. Expenditures and encumbrances (\$305.8 million) through November constitute 41.8% of the total 2003-2004 revised budgeted uses of funds (\$732.1 million, excluding reserves).

On an overall basis, cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through November. Through November, only one department, the Fire Department, as described below, was spending at a level that would lead to exceeding its appropriation at year-end. In the capital project expenditure category, the Animal Control Facility capital project also appears to be in danger of exceeding budgeted levels.

**GENERAL FUND (CONT'D.)**

**EXPENDITURES (CONT'D.)**

The following discussion highlights General Fund expenditure issues:

**KEY GENERAL FUND EXPENDITURES**  
(\$000's)

<u>Department</u>	2003-2004 <u>Budget</u>	YTD <u>Actual</u>
<b>Police</b>	<b>\$ 226,489</b>	<b>\$ 86,208</b>

Overall, Police Department expenditures are tracking at slightly lower than estimated levels through November. Overtime expenditures through November were below expected levels at \$2.2 million or 30.7% of the budgeted level (compared to the estimated level of 39.8%). In February 2003, the Department implemented guidelines on overtime usage and the Department continues to be proactive in managing overtime usage. In the Sworn Recruitment and Training Program, 33 Officers that were part of the January 2003 Academy were street-ready in October.

The compensatory time balance at the end of November is 212,254 hours for sworn personnel. This level represents a drop of 7,141 hours (down 3.2%) from the June 2003 balance of 219,395 hours, and a slight decrease from the November 2002 balance of 218,288 hours.

<u>Department</u>	2003-2004 <u>Budget</u>	YTD <u>Actual</u>
<b>Fire</b>	<b>\$ 113,255</b>	<b>\$ 44,758</b>

As discussed in the October MFR, on an overall basis, expenditures for the Fire Department continue tracking above budgeted levels. This is entirely the result of higher than anticipated departmental Personal Services expenditures, resulting primarily from the Department's current paramedic staffing situation, and the costs for Mutual Aid fire support provided to fight the Southern California wildfires.

Early projections indicate that at current levels, year-end costs would exceed budgeted levels by as much as \$1.3 million. A portion of that overage should be reimbursed. In support of efforts to fight Southern California wildfires, the Fire Department dispatched four companies and support staff. The Department is currently obtaining further information on the total amount and timing for the reimbursement of these costs. At current spending levels, assuming full reimbursement for the Mutual Aid efforts, the department's unreimbursed year-end costs would be over the budgeted amounts by between \$0.8-1.0 million.

**GENERAL FUND (CONT'D.)**

**EXPENDITURES (CONT'D.)**

**KEY GENERAL FUND EXPENDITURES**  
(\$000's) (Cont'd.)

<u>Department</u>	<u>2003-2004 Budget</u>	<u>YTD Actual</u>
<b>Fire (Cont'd.)</b>	<b>\$ 113,255</b>	<b>\$ 44,758</b>

Efforts continue to address the inadequate paramedic staffing levels in the department. As of the end of November, the Department has a total of 205 filled front-line (122) and support (83) paramedics. As discussed during last year's budget process, the front-line total of 122 is short of the 147 that are necessary to fully staff all apparatus. During last fiscal year, the Department implemented several strategies to attempt to close the gap in front-line paramedics. In March 2003, the accelerated accreditation program for 13 Firefighter Paramedics resulted in an increase in the number of front-line Paramedics. In addition, 16 individuals have completed a Paramedic Academy and are in the internship phase of their training. A significant portion of the projected overexpenditure will, however, result from an unanticipated delay in the length of time necessary for these medics to complete the certification process. For reasons that are still unclear, the training program is now approximately four months behind the original schedule. This delay alone will result in unbudgeted overtime costs of just under \$400,000, nearly half of the projected overexpenditure. When the front-line Paramedics are accredited, the number of front-line Paramedics is anticipated to increase to a projected level of 133, still slightly short of the full need. The Budget Office is continuing to work with the Department to develop mitigation strategies to bring expenditures within budgeted levels by year-end.

<u>Department</u>	<u>2003-2004 Budget</u>	<u>YTD Actual</u>
<b>Capital Contributions</b>	<b>\$ 29,437</b>	<b>\$ 5,672</b>

Under the current schedule, the Animal Shelter Facility project is scheduled to be substantially complete in February 2004 and operations are expected to begin in April 2004. The Public Works Department now reports, however, that the 2003-2004 appropriation for this project of \$3.7 million will be exceeded by just over \$0.5 million (the total project budget is currently \$17.1 million). The additional funding will be necessary to close out the project and address several needed items that were not included in the original project scope.

**GENERAL FUND (CONT'D.)**

**EXPENDITURES (CONT'D.)**

**KEY GENERAL FUND EXPENDITURES**  
**(\$000's) (Cont'd.)**

<u>Department</u>	<u>2003-2004</u> <u>Budget</u>	<u>YTD</u> <u>Actual</u>
<b>Capital Contributions (Cont'd.)</b>	<b>\$ 29,437</b>	<b>\$ 5,672</b>

These items include the following: anticipated negotiated settlement amounts to address contractor claims of extended overhead costs; additional change orders to address unforeseen conditions on the job site, changes in the operating strategy for the facility, and changes to clarify details and requirements in the architectural plans; Public Works project delivery costs; and a new security/alarm system and a truck washing area. The exact amount of the overage is currently still under review. A memorandum will be submitted for Council consideration later this month with a reconciliation of the overage and a proposed funding plan.

**CONTINGENCY RESERVE**

Through November, the General Fund Contingency Reserve was \$22,886,675, down by \$2.2 million from the 2003-2004 Adopted Budget level of \$25,086,675. The following revisions to the contingency reserve were approved through November:

- A decrease of \$600,000 to provide an increase to the Hayes Mansion Conference Center Line of Credit in order to allow the Conference Center to remain open and operational while the City selects and completes negotiations with a new property manager.
- A decrease of \$1.5 million to provide or guarantee a letter of credit on behalf of the Silicon Valley Football Classic.
- A decrease of \$100,000 to provide funding for an environmental impact report for the Almaden Youth Sports Complex.

## **OTHER FUNDS**

### **Construction and Conveyance Tax Funds**

Continuing the positive trend experienced at the end of last fiscal year, Construction and Conveyance Tax collections through the first five months of the year have significantly exceeded both prior year actuals and budgeted estimates. Tax revenues from this source are continuing to exceed expectations due to stronger than anticipated durability of the local real estate market, which to our surprise continues to remain virtually unfazed by the local economic slowdown. The number of property transfers for all types of residences in November increased over 14% from November 2002, and these homes also took less time to sell with the average days-on-market decreasing from 63 days in November 2002 to 51 days in November 2003. Year-to-date property transfers have also increased by approximately 26% when compared to prior year activity.

Through November, \$12.0 million in actual tax revenues has been received (60.0% of the 2003-2004 estimate of \$20 million). This collection level was 48.8% higher than revenues received through November 2002. In addition to these revenues, the City has since received December Conveyance Tax receipts which totaled \$2.4 million. This result was 33.3% higher than the December 2002 amount of \$1.8 million. The 2003-2004 budgeted estimate, by contrast provided for a 19% decrease from the 2002-2003 collection level. While the news remains positive and we will likely end the year above budgeted levels, we should continue to exercise caution when projecting year-end receipts. The prolonged economic downturn, and the end of the recent decline in mortgage rates could still begin to negatively impact housing sales, which are the primary drivers of this revenue.

### **Other Construction-Related Revenues**

After a first quarter during which revenue performance aligned fairly closely with estimates and a surprisingly strong October, in November construction-related revenues dropped to the lowest levels this fiscal year. Despite November's lackluster performance, revenues are still tracking above year-to-date estimates. The year-to-date total of the seven revenue sources monitored for this report is \$11.9 million, an increase of 30.6% from the \$9.1 million collected through the same period last year. Despite the stronger than anticipated showing to date, we continue to believe that this does not indicate the revival of industrial construction activity. A recovery in that sector would appear to still be some time away. Nevertheless, on an overall basis activity in the other sectors, primarily residential, has boosted revenues above year-to-date estimates for 2003-2004, which was built allowing for a 33.6% drop from the prior year's actual collections of \$30.0 million.

The revenue picture is somewhat mixed across sources within this category. The major revenue sources – Building and Structure Construction Taxes and Construction Excise Taxes – are outperforming year-to-date estimates as well as prior year actuals. Building and Structure Tax receipts through November totaled \$4.1 million (56.0% of the current 2003-2004 estimate of \$7.3 million), which represents an increase of 26.4% from the revenues collected through the same period last year (\$3.2 million).



## OTHER FUNDS (CONT'D.)

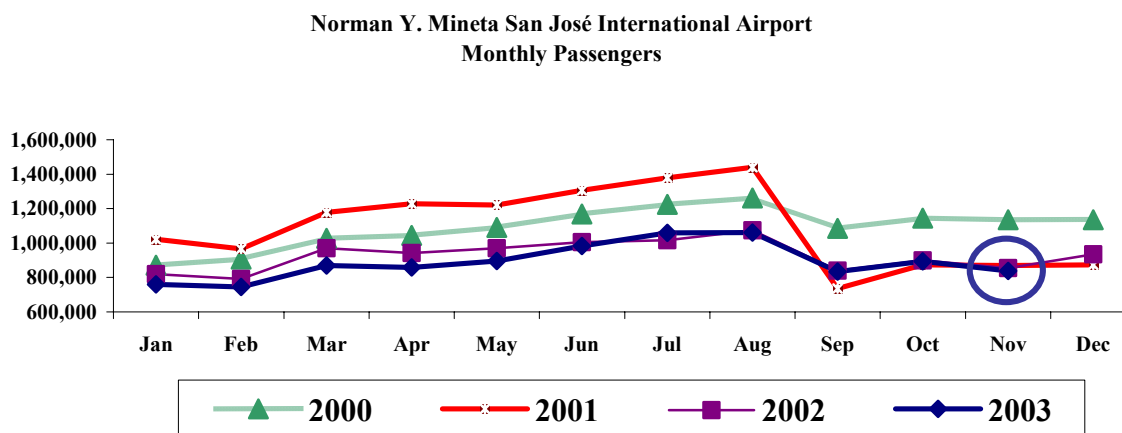
### Other Construction-Related Revenues (Cont'd.)

The budgeted estimate for this category allows for a 32.4% drop. Construction Excise Tax revenues through November totaled \$6.0 million (54.6% of the current 2003-2004 estimate of \$11.0 million), which represents an 17.5% increase from last year's \$5.1 million received over the same period. The budgeted estimate for this category allows for a 35.1% drop in 2003-2004.

Other construction related revenues are generated by Municipal Water Service Connection Fees, Sanitary Sewer Fees, Storm Drain Fees, Residential Construction Taxes, and Municipal Water Major Facilities Fees. All of these categories are tracking above prior year levels and are expected to end the year at or above estimates.

### Airport Funds

As expected, activity at the Airport remains sluggish. Through November, the Norman Y. Mineta San José International Airport (SJC) enplaned and deplaned 4.7 million passengers, an increase of only 0.1% from the figures reported through November 2002, and all of that small amount of growth was due to increased July activity. Monthly passenger activity for November, by contrast, was down 2.1% from 2002 levels. In November 2003, the Airport served 837,379 passengers.



Terminal C passenger activity for November 2003 increased 1.5%, while year to date activity is 5.8% greater than that recorded through November 2002. Terminal C air carriers reporting reduced passenger totals are Alaska, Continental, Delta, Northwest, and United. Those experiencing passenger growth include America West, American Trans Air, Frontier, Horizon, Mexicana, and Skywest. Terminal A activity decreased 4.0% in November-to-November comparisons and is 2.9% lower than 2002-2003. Although American Eagle and Southwest reported increases in activity, American Airlines decreased almost 26.0% from 2002-2003 activity. The combination of American Airlines and American Eagle results in a net decrease of 10.8% from 2002-2003. American's international activity, however, rose 13.0% over November 2002 and is up 4.7% year to date.

## **OTHER FUNDS (CONT'D.)**

### **Airport Funds (Cont'd.)**

Mail, freight and cargo totaled just over 98 million pounds, a 24.3% decrease from 2002-2003. The decrease is largely attributable to the termination of operations of Emery Worldwide Airlines and Kitty Hawk Air Cargo, although all cargo carriers showed reduced levels of activity. November 2003 taxicab operations decreased by 0.1% from those in November 2002, and are 2.5% lower than those recorded year to date in 2002-2003.

Reflecting conservative revenue estimates, as of November 30, 2003, year to date operating revenues of \$34.77 million were 0.8% higher than budget. Performance of various revenue categories showed mixed results. Revenues posting higher results than budget were terminal rentals, airfield, parking and roadway, and general and non-aviation revenues. Terminal rentals were 4.0% higher than budget due to additional space occupied by Southwest Airlines. Airfield revenues continued to outpace budget because of the rise in the activities of the commuter airlines. Parking and roadway revenues came in 3.0% higher than the prorated budget largely due to higher than anticipated activities in short term parking. The growth can also be attributed to the increase in activities of other ground transportation service providers, specifically the offsite parking providers. Higher interest income and a transfer from the fiscal agent fund as well as increase in land and building rentals contributed to the 27.0% increase in general and non-aviation revenues.

Revenues falling behind budget included landing fees, terminal concessions and miscellaneous rents, and petroleum program. Lingering weak passenger traffic caused the airlines to decrease flight activities that correlated to lower landing fees. Terminal concessions and miscellaneous rents were 9.0% lower than budget due to "true-up" refunds of concession fees paid to the rental car companies (approximately \$822,000). Excluding the "true-up" refunds, terminal concessions and miscellaneous rents actually experienced a 4.0% growth. The petroleum program was only 92.0% of the budget because of the termination of operations by Kitty Hawk and Charter America, which accounted for 17.0% of the prior year's petroleum revenues.

Expenditures in the Airport Maintenance and Operations Fund through November are tracking below budgeted levels in both personal services and non-personal/equipment categories. In personal services, expenditures totaled 37.1% of budget compared to a benchmark of 39.8%. Savings are attributed to departmental vacancies and reduced overtime expenses. Through the end of November, the Airport carried 61 vacancies, of which 33 were funded.

Overtime to date totaled \$57,741 (14.2% of budget), as compared to \$84,358 spent year to date in 2002-2003. Overtime at the Airport is used to provide critical holiday coverage, after hours support, maintain mandated staffing levels and provide emergency response. The department remains attentive to the need to control overtime both for pay and for comp-time and continues to seek approval by the City to provide adequate staffing for peak periods through the use of part-time staff rather than the expensive use of comp-time where staffing levels are not adequate to allow for usage of comp-time balances.

## **OTHER FUNDS (CONT'D.)**

### **Airport Funds (Cont'd.)**

Non-personal/equipment expenditures through November are \$9.3 million, or 23.0% of the 2003-2004 budget. Actual expenditures for this period are well below the non-personal/equipment benchmark of 30.8%. At this time, non-personal/equipment savings recorded to date should be viewed as preliminary. Expenditure data through November is considered within budget.

Year to date revenues from the Airport Customer Facilities and Transportation Fee Fund, adjusted for amounts past due, total just under \$1.5 million. These total revenues are 1.9% less than year to date 2002-2003 levels and are 3.2% less than anticipated. Expenditures in the fund total \$1.6 million and are 3.9% less than expenses through November 2002 and 13.4% less than the benchmark level of 36.9%. Expenditures are tracking lower than anticipated due to reduced bus operator, maintenance and fuel costs.

### **Transient Occupancy Tax Fund**

As described above, Transient Occupancy Tax (TOT) collections of \$1.6 million through November remain disappointing, and were down 8.0% from the same period last year. As shown above, the November 2003 occupancy rate in the largest hotels of 42.2% was significantly down from the November 2002 rate of 50.4% and below the October 2003 rate of 50.4%. In addition, reflecting the soft market, while the number of rentable rooms remained stable over the prior year, the average room rate continued to slip, dropping to \$107.22 in November 2003 from \$115.46 in November 2002.

Based on these trends, it is almost certain that collections in this fund will end the year well below the \$6.7 million budget. Staff will continue to monitor this fund closely, but we believe a significant downward adjustment in the revenue estimates for this fund will prove necessary at mid-year. This was apparent several months ago and the three recipients of the proceeds of this fund placed on notice that further reductions in their budgeted allocations for the year will undoubtedly be necessary.

### **Integrated Waste Management Fund**

Overall, Integrated Waste Management Fund revenues are tracking to end the year at 1.5% below estimate, primarily due to customers downsizing their carts in both Single-Family and Multi-Family Dwelling sectors further than anticipated. However, it is expected that related expenditure savings will compensate any shortfall in revenue.

## CONCLUSION

Economic indicators and City revenue collections confirm the fact that the City and the south bay region continue to be mired in a lingering economic slowdown, and appear likely to remain so for the immediate future. Since the revenue estimates in the Adopted Budget assumed this approximate situation, however, we believe that performance to date is still generally consistent with budgeted estimates. As discussed above, the outcome of the State battle over VLF backfill revenues for local governments, and our own Sales Tax performance for the remainder of the year will be the critical determinants of our final status.

Although the breadth and depth of the weak local economy has clearly been greater and longer than any of us anticipated, to date we have been able to weather the situation relatively well, largely due to the aggressive management measures implemented as soon as it became apparent that the economy had peaked. We remain committed to the strict enforcement of these cost controls, and the development of options for further cost cutting for Council consideration should the situation begin to deteriorate.

At this point however, the largest danger facing the City is external -- the loss of VLF revenue and the ongoing debate at the State level concerning efforts to prevent the drastic impact on local government services statewide if the backfill is not restored. The \$28 million hole in the City of San Jose's 2003-2004 General Fund budget that would result, should the backfill be lost will require swift and painful actions to bring City finances back into balance. Contingency planning for that outcome has been underway for some time and the staff stand ready to bring recommendations to the Council quickly should that prove necessary.

Regardless of the outcome of the current State process, tough decisions lie ahead. Our projections call for large shortfalls in our own revenues, and the Governor is scheduled to release a budget for the 2004-05 State fiscal year that will have great implications for our situation depending on its treatment of local government reimbursements.

Planning has been under way for some time within the Administration to develop options for how to address next year's situation, no matter how dire it may be. We remain confident, that no matter how large the problem we face, our track record of prudent financial planning will continue to serve us well, and that working together we can and will respond appropriately.

As always, staff will continue to closely monitor our current year financial status and report regularly to the City Council on any and all significant developments through this reporting process.

LARRY D. LISENBEE  
Budget Director